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Clients&FriendsMemo

Reforms to the Asset-Backed Securitization Process and the Regulation of Credit Rating Agencies Under the Dodd-Frank Wall Street Reform and Consumer Protection Act*

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On July 15, 2010, the Senate voted in favor of adopting the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Act**"). The Act is far reaching in scope and represents the culmination of months of debate and intense lobbying.

The Act was precipitated by the financial crisis that began in 2007 and therefore its primary goal is to prevent a recurrence. Since the asset-backed securitization market and credit rating agencies have both been the subject of criticism in connection with the financial crisis, it comes as no surprise that Congress has included provisions in the Act that address both of these areas of the financial markets. However, like many other parts of the Act, the provisions regarding asset-backed securities and rating agencies will require a heavy dose of regulations and studies before the full impact of the Act will be understood.

The focus of this Memorandum is Title IX – Subtitle D "Improvements to the Asset-Backed Securitization Process" and Title IX – Subtitle C "Improvements to the Regulation of Credit Rating Agencies".

I. Asset Backed Securitization Process

Subtitle D of Title IX is entitled "Improvements to the Asset-Backed Securitization Process" and is an attempt by Congress to reform the asset-backed securitization process by instituting requirements for (i) risk retention ("skin in the game"), (ii) increased disclosure and (iii) ongoing periodic reporting. These provisions are summarized below.

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* Cadwalader has prepared a short summary of the Act and a series of memoranda focused on the Act's application to specific industries, entities and transactions. To see these other memoranda please see a *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Appendix A links to the various topic-focused memoranda) or visit our website at http://www.cadwalader.com/list_client_friend.php.

Certain of the provisions discussed below overlap with various proposals contained in the SEC's proposed revisions to Regulation AB and in the FDIC's Notice of Proposed Rulemaking[1] regarding safe harbors for bank-sponsored securitizations. It is unclear how the FDIC and the SEC will adapt their proposals in light of the Act. Attached to this memorandum is a chart that compares and contrasts some of the key overlapping points in these initiatives.

A. Risk Retention

The most significant portion of the Act for participants in the asset-backed securities market is the introduction of a risk retention requirement. The Act provides that by no later than 270 days after the Act is signed by President Obama and enacted into law, the applicable regulators are required to jointly prescribe risk retention regulations that will apply to securitizers of asset-backed securities ("**ABS**"). It is important to note that while the Act gives specific directives to the applicable regulators on certain aspects, there are many points that are left to the regulators to consider and determine. For this reason there is still uncertainty as to a number of material elements of the new risk retention requirements.

Note: The requirement that the applicable regulators work jointly to prescribe regulations seems to increase the likelihood that the resulting regulations will have uniform application to all types of securitizers, regardless of the regulatory regimes to which they are subject. Consistent regulations would allay industry concerns that insured depository institutions might be disadvantaged by more stringent regulation of securitization activities than non-insured depository institutions.

1. Effective Date

The final risk retention regulations will become effective:

(a) in the case of securitizations of residential mortgage loans, one year after the final regulations are issued; and

(b) in the case of all other ABS, two years after the final regulations are issued.

[1] *See* Clients & Friends Memo: SEC Proposes Significant Enhancements to Regulation of Asset-Backed Securities and Clients & Friends Memo: FDIC Seeks "Stronger, Sustainable Securitizations" by Imposing Additional Conditions to Eligibility for Securitization Safe Harbor.

Note: Since the applicable regulators are given nine months to finalize regulations, and the risk retention rules will be effective either one or two years thereafter, it appears that the risk retention rules will not come into effect until approximately April 2012 for RMBS, and April 2013 for CMBS and all other forms of ABS.

2. Applicable Regulators

Congress has charged the Federal banking agencies (the Office of the Comptroller of the Currency ("**OCC**"), the Federal Deposit Insurance Corporation ("**FDIC**") and the Board of Governors of Federal Reserve System ("**Federal Reserve**")), the Securities and Exchange Commission ("**SEC**"), and with respect to securitizations of residential mortgage loans, the Secretary of Housing and Urban Development ("**HUD**") and the Federal Housing Finance Agency ("**FHFA**"), with the responsibility of jointly prescribing the risk retention regulations that will apply to securitizations.

3. Applicability of Risk Retention Rules: Which Deals and Which Parties?

The Act amends the Securities Exchange Act of 1934 (the "**Exchange Act**") to formally define the terms "asset-backed securities," "securitizer" and "originator" in a manner that is generally consistent with industry usage. These terms are key to applying the risk retention rule, which requires that risk be retained by a "securitizer" or "originator" of "asset-backed securities," as further described in this memo.

"**Securitizer**" means (i) an issuer of an asset-backed security or (ii) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.

"**Asset-backed Securities**" —

(a) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including:

(i) a collateralized mortgage obligation;

(ii) a collateralized debt obligation;

(iii) a collateralized bond obligation;

(iv) a collateralized debt obligation of asset-backed securities;

(v) a collateralized debt obligation of collateralized debt obligations; and

(vi) a security that the SEC, by rule, determines to be an asset-backed security for the purposes of the risk retention requirements of the Act; and

(b) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.

"**Originator**" means a person who —

(a) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and

(b) sells an asset directly or indirectly to a securitizer.

4. Items to be Addressed in the Regulations

(a) **Risk Retention Percentage.** Subject to certain exceptions or adjustments described below, the regulations are required to provide that securitizers retain a minimum of 5% of the credit risk of any asset transferred into a securitization.

Note: Unlike the proposed revisions to Regulation AB, the Act requires risk retention for all offerings of ABS, not just those offered under a shelf-registration statement.

(b) **Prohibition on Hedging.** A securitizer is to be prohibited from directly or indirectly hedging or otherwise transferring the credit risk that it is otherwise required to retain.

(c) **Form and Duration of Retention.** The regulators are to prescribe regulations detailing the form and duration of risk retention required for each asset class.

Note: The SEC's Regulation AB proposals would require that a "vertical slice" of each class of ABS offered pursuant to a shelf registration statement be retained for as long as any third party owns related securities. While it seems likely (given that the Act grants increased regulatory authority to the SEC) that the risk retention requirement will be increased beyond that indicated in the SEC's Regulation AB proposals, it is unclear whether the "vertical slice" approach will be retained. It seems unlikely that the duration of the required retention period will be decreased.

(d) **Allocation of Risk Retention Between Securitizer and Originator.** The Federal banking agencies and the SEC, as they may deem appropriate, may allocate the risk retention requirement between a securitizer and an originator, with the amount of any retention by an originator resulting in a reduction of the retention otherwise required of the securitizer. In determining any such allocation, the regulators must consider (i) whether the assets have terms, conditions and characteristics that reflect low credit risk, (ii) whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of asset and (iii) the potential impact of the risk retention obligations on access of consumers and businesses to credit on reasonable terms.

(e) **Exemptions, Exceptions and Adjustments to Risk Retention.**

(i) Regulatory Discretion. The regulators may provide for the total or partial exemption from the risk retention requirements for any securitization, as they determine is appropriate in the public interest and for protection of investors.

The regulators may also adopt exemptions, exceptions or adjustments to the rules requiring risk retention and prohibiting hedging of such retention if they help ensure high quality underwriting standards for securitized assets and encourage appropriate risk management practices

by securitizers and originators, improve access of consumers and businesses to credit on reasonable terms, or are otherwise in the public interest and for protection of investors.

(ii) Adjustment to 5% Retention Based on Prescribed Underwriting Standards. The regulators are required to establish underwriting standards for each asset class of ABS (*e.g.*, ABS backed by residential mortgage loans, commercial mortgage loans, commercial loans, auto loans and any other asset class that the regulators deem appropriate) that specify the terms, conditions and characteristics of a loan within the asset class that indicate a low credit risk with respect to such loan. The rules adopted by the regulators are required to provide that securitizers may retain less than 5% credit risk if the assets meet the applicable underwriting standards.

(iii) Exemption for Qualified Residential Mortgages. The Act requires that the regulations specify that the risk retention requirements will not apply to an ABS transaction where all of the assets in the ABS are "qualified residential mortgages." The regulators must jointly define the term "qualified residential mortgages", taking into consideration underwriting and product features that historical loan performance data indicate will result in a lower risk of default, such as:

- documentation and verification of the financial resources relied upon to qualify the mortgagor;
- standards with respect to:
  - the residual income of the mortgagor after all monthly obligations;
  - the ratio of the housing payments to the monthly income of the mortgagor; and

- the ratio of total monthly installment payments to the income of the mortgagor;

- mitigating the potential for payment shock on adjustable rate mortgages through product features and underwriting standards;

- mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

- prohibiting or restricting the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

In addition, the regulators may not define "qualified residential mortgage" to be any broader than the definition of "qualified mortgage" as defined under Section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder.

In order for an ABS to fall within the qualified residential mortgage exemption, an issuer will be required to certify to the SEC that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the ABS are qualified residential mortgages.

Note: The foregoing exception for ABS backed by qualified residential mortgage loans will not apply to resecuritizations.

(iv) Alternatives for Commercial Mortgages. With respect to commercial mortgage loans, the regulations must specify the types, forms and amounts of risk retention, which may include:

- retention of a specified amount or percentage of the total credit risk of the assets;
- retention of the first-loss position by a third-party purchaser that specifically negotiates for the purchase of such first-loss position, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before issuance of the ABS and meets the same standards for risk retention as the regulators require of the securitizer (presumably including the prohibition on hedging the credit risk retained);
- a determination by the Federal banking agencies and the SEC that the underwriting standards and controls for the asset are adequate; and
- provision of adequate representations and warranties and related enforcement mechanisms.

Note: The Act only provides that the regulators may include accommodations for the foregoing, but the regulators are not required to do so. It is unclear to what extent the regulators may be willing to reject these concepts, though specified in the Act.

(v) Governmental Guarantee Exemption. The risk retention requirements will not apply to:

- any loan or other financial asset made, insured, guaranteed, or purchased by any institution that is subject to the supervision of the Farm Credit

Administration, including the Federal Agricultural Mortgage Corporation; or

- any residential, multifamily or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the U.S. or an agency of the U.S.

Note: For this purpose, securities insured or guaranteed by Fannie Mae, Freddie Mac or the Federal home loan banks are not to be treated as insured or guaranteed by the U.S. or an agency of the U.S.

(vi) Regulations for CDOs Singled Out. The Act specifically identifies collateral debt obligations ("**CDOs**"), securities collateralized by CDOs and similar instruments collateralized by other ABS (*e.g.*, resecuritizations) as an asset class that the regulators must establish appropriate standards for risk retention.

Note: It is possible that regulators could fashion rules that are more onerous on securitizers of these asset classes.

(f) **Asset Class Specific Regulations.** Because it would be difficult to implement a one-size-fits-all requirement, the Act requires regulators to prescribe separate risk retention regulations for securitizers of different asset classes.

B. Study on Risk Retention

The Federal Reserve, in coordination and consultation with the other regulators, is required to conduct a study of the combined impact on each asset class of the new credit risk retention requirements, including the effect those requirements will have on increasing the market for Federally subsidized loans and the impact such requirements will have on securitizers under the new accounting rules of FAS 166 and FAS 167. A report on such study is required to be delivered to Congress no later than 90 days after the Act is enacted and the report is required to contain statutory and regulatory recommendations for eliminating any negative impacts on

the viability of the asset-backed securitization markets and the availability of credit for new lending.

C. Ongoing Reporting

The Act eliminates the ability of an ABS issuer to "de-list" ABS transactions and suspend periodic reporting. Previously, issuers of ABS in SEC-registered offerings were permitted (under Section 15(d) of the Exchange Act) to suspend periodic reporting under the Exchange Act for ABS offered in a transaction registered under the Securities Act of 1933 (the "**Securities Act**"). These offerings typically suspended reporting after the end of the year of issuance because the securities are held by less than 300 persons. Nevertheless, the Act does give the SEC the authority to issue rules and regulations that could provide ABS issuers the right to suspend or terminate such ongoing reporting requirements as the SEC deems necessary or appropriate in the public interest or for protection of investors.

Note: The elimination of an ABS issuer's ability to suspend its Exchange Act filings is effective immediately. Because the ability to suspend reporting is tested on an annual basis, the exclusion of ABS from the suspension provisions in Section 15(d) of the Exchange Act could be interpreted as applying to ABS issued prior to the effective date of the Act, which would have an adverse effect on ABS issuers that previously qualified for suspension and whose transaction documents did not anticipate ongoing reporting. Industry participants believe that the amendments to Section 15(d) were only intended to apply to ABS issued after the effective date of the Act and have requested confirmation from the SEC. Consequences of ongoing reporting obligations include, among others, (i) preparing and filing annual Sarbanes-Oxley certifications by the senior officer in charge of securitization at the depositor or senior servicing officer at the servicer, and (ii) the failure to timely comply with any Exchange Act reporting requirement disqualifies an issuer from filing a new shelf-registration statement (although take-downs from existing shelf registration statements would not be impacted).

D. Additional Regulations

The Act requires the SEC to issue regulations addressing the following additional matters:

1. Regulations to enhance the disclosure regarding the assets that back ABS. These regulations are required to address:

   (a) standardized formats for providing data to facilitate the comparison of data across securities types of ABS; and

   (b) loan-level or asset-level data if such data is necessary for investors to independently perform due diligence.

   Note: No time frame is specified for the issuance of these regulations, but much of these disclosure enhancements are addressed by the SEC's proposed revisions to Regulation AB.[2]

2. Regulations regarding the use of representations and warranties. These regulations must:

   (a) require each rating agency rating an ABS to include in any reports they issue regarding the ABS, a description of (i) the representation and warranties and enforcement mechanisms and (ii) how they compare to the representation and warranties in issuances of similar securities; and

   (b) require a securitizer to disclose its fulfilled and unfulfilled repurchase requirements for alleged breaches of representations and warranties so that investors can identify originators with clear underwriting deficiencies.

3. Regulations relating to due diligence on publicly offered ABS. These regulations will address publicly offered ABS and require an ABS issuer to:

   (a) perform a review of the assets underlying the ABS; and

   (b) disclose the nature of such review.

[2] *See* Clients & Friends Memo: SEC Proposes Significant Enhancements to Regulation of Asset-Backed Securities.

Note: It remains to be seen how the regulators will implement this directive.

4. Third-Party Due Diligence Reports. The Act also requires that issuers and underwriters of ABS make publicly available the findings and conclusions of any third-party due diligence report that they obtained. See also "Rating Agency Regulation—Transparency—Third Party Reports" below.

E. Prohibitions on Conflict of Interest Relating to Securitizations

The Act prohibits an underwriter, placement agent, initial purchaser or sponsor of an ABS (or any of their subsidiaries or affiliates), during the one-year period after the first closing of a sale of such ABS, from engaging in any transaction that would involve or result in a material conflict of interest with respect to any investor in a transaction arising out of such activity.

The SEC is required to issue rules not later than 270 days after enactment of the Act regarding the implementation of this prohibition. The prohibition will take effect on the date the rules are issued by the SEC.

This prohibition does not apply to:

1. risk mitigating hedging activities in connection with positions held as a result of the placement or sponsorship of the ABS; or

2. purchases and sales of the ABS pursuant to commitments made by such parties to provide liquidity for the ABS or bona fide market-making activities.

F. Removal of Registration Exemption for Mortgage Securities and Notes

The Act deletes Section 4(5) of the Securities Act , which exempted certain mortgage securities and notes from the registration requirements of the Securities Act.

Note: This was not often relied upon as an exemption from the Securities Act registration requirements.

II. Rating Agency Regulation

Subtitle C of Title IX is entitled "Improvements to the Regulation of Credit Rating Agencies" and institutes reforms in the regulation, oversight and accountability of nationally recognized statistical rating agencies ("**NRSROs**"). The Act expresses Congressional concerns with the conflicts of interests faced by credit rating agencies and with the inaccuracy of ratings on structured finance products, which "contributed significantly to the mismanagement of risks by financial institutions and investors," resulting in the need for "increased accountability on the part of credit rating agencies." As a result, most of the provisions of Subtitle C are directed at the rating agencies themselves, who will be under heightened SEC scrutiny and increased regulation, rather than the issuers or underwriters who request ratings or the investors who rely on ratings. These provisions are summarized below and highlight the nature and scope of attention that will be focused on credit rating agencies going forward. The Congressional findings conclude that the inaccuracy of ratings on structured products adversely impacted the health of the economy in the United States and around the world. The consistent theme of the provisions of Subtitle C is to identify and eliminate conflicts of interest and restore confidence in the ratings process.

A. Internal Controls

1. Each NRSRO must implement an internal control structure. The SEC will establish rules requiring an annual report from the rating agency describing the responsibility of management in establishing and maintaining effective internal controls, assessing the effectiveness of its internal controls, and an attestation of the CEO.

2. The NRSRO must have a designated compliance officer who may not perform credit ratings and whose compensation is not linked to the agency's financial performance. The compliance officer will submit annual reports to the SEC describing the agency's compliance with securities laws and its own internal policies and procedures.

3. The NRSRO must have a board of directors consisting of one-half, but no fewer than two, independent directors, including users of ratings.

B. Conflicts

1. The SEC will promulgate rules to prevent sales and marketing considerations from influencing ratings.

2. If a former employee of an NRSRO is hired by an issuer, underwriter or sponsor of a security rated by the NRSRO, the rating agency must review its ratings for any such entity or securities in which such employee participated during the one year period prior to the rating action to determine whether any conflicts existed.

3. Each NRSRO must report to the SEC the names of certain former employees of the agency who, within the previous five years, became an employee of any issuer, underwriter, or sponsor of a security rated by such agency, and who participated in the rating process during the twelve months prior to such employment. The SEC will make this information publicly available.

C. SEC Oversight

1. The SEC will establish an Office of Credit Ratings ("**OCR**"), whose stated purpose is to administer SEC rules to:

   (a) protect users of credit ratings and in the public interest;

   (b) promote accuracy of ratings issued by NRSROs; and

   (c) ensure that ratings are not unduly influenced by conflicts of interest.

2. The OCR will conduct annual examinations of each NRSRO and make a summary of its findings publicly available.

3. The annual examination will include a review of whether the agency conducts its business consistent with its own policies, procedures and methodologies; its management of conflicts of interest; its supervisory controls; its processing of complaints; and its policies regarding post-employment activities of its former staff.

D. Transparency

1. The SEC will adopt rules requiring that each NRSRO disclose comparable information regarding its ratings, including performance information, so that users can compare the performance of credit ratings issued by different agencies.

2. Each rating must be accompanied by a detailed description of the rating, including the assumptions and methodologies underlying the rating, the data used in determining the rating, and how servicer or remittance reports are used to conduct surveillance.

   (a) The form of the report will also include qualitative information, such as information regarding the uncertainty of the ratings, including information on the reliability, accuracy and quality of the underlying data, and a description of the scope and findings of third party reports used in establishing the rating.

   (b) Quantitative information is also required, including information regarding performance, probability of default and expected losses, sensitivity to certain assumptions, and a description of five assumptions that would have the greatest impact on the rating if the assumptions were false or inaccurate.

3. Third party reports: Issuers or underwriters of ABS must make publicly available the findings and conclusions of any third party reports. Any report used by a NRSRO must be accompanied by a certification from the author of the report in order to ensure that the report is based on a thorough review of data and other relevant information necessary for the NRSRO to provide an accurate rating. The certification must be made publicly available by the NRSRO.

   Note: The SEC has given verbal clarification to the American Securitization Forum that the Act requires the SEC to issue rules within one year of enactment addressing how and under what circumstances third party reports should be made publicly available.

4. In issuing their ratings, NRSROs should consider credible and potentially significant information received from sources other than an issuer or underwriter.

E. Liability and Statutory Changes

1. Private Right of Action and "State of Mind". The Congressional findings related to Subtitle C conclude that the activities of credit rating agencies should be subject to the same standards of liability as auditors and analysts. Thus statements made by a credit rating agency will be subject to the enforcement and penalty provisions applicable to accountants and

securities analysts. In an action for securities fraud by a private plaintiff against a credit rating agency, the required "state of mind" is that the credit rating agency knowingly or recklessly failed to conduct a reasonable investigation of the facts it relied upon or to obtain reasonable verification of the facts from other competent sources independent of the issuer and the underwriter.

Note: Transaction parties providing indemnification to the rating agencies should carefully consider expanded rating agency liability to investors to which indemnifying parties may be exposed.

2. SEC Sanctions. The SEC may sanction or penalize the NRSRO or its employees for misconduct. The SEC may suspend or revoke the NRSRO's ability to rate a class of securities if it finds that the agency does not have adequate resources "to consistently produce credit ratings with integrity."

3. Rescission of Rule 436 (g). For public offerings registered under the Securities Act, initial ratings by NRSROs will now be considered part of the registration statement. As with accountants who include their report on audited financial statements in the registration statement (or prospectus), the consent of the rating agency must be filed with the SEC prior to use of the rating information in connection with the offering of securities. No longer exempt from the liability provisions of Section 11 of the Securities Act, a NRSRO will have liability for information regarding its rating unless it can sustain the burden of proof that it had no reasonable grounds to believe that the information was untrue or misleading.

Note: On July 15, 2010, Moody's Investors Service released a commentary describing the effect of the Act on its activities, and noted that "given the potential legal consequences, we cannot consent to the inclusion of ratings in prospectuses and registration statements without further study." In a statement issued on July 16, 2010, Standard & Poor's said that it would "explore mechanisms outside of the registration statement to allow ratings to continue to be disseminated to the debt markets" and also noted that its ratings on new issues and pre-sale reports would be available on their website. ABS issuer's, on the other hand, noted that they are required under Items 1103 and 1120 of Regulation AB to disclose in a prospectus the ratings of their registered ABS. In response to the resulting standstill in registered ABS issuance and in order to facilitate a transition for ABS issuers, on July 22, 2010,

the SEC issued a no-action letter in which the SEC stated that it will not recommend enforcement actions if an ABS issuer fails to comply with Items 1103 and 1120 of Regulation AB and omits the disclosure of the ratings of registered ABS from a prospectus. The no-action letter is due to expire on January 24, 2011. ABS issuers can still disclose the ratings of offered ABS in a free writing prospectus in accordance with Rule 433 of the Securities Act without obtaining and filing rating agency consents.

4. Repeal of Exemption from Regulation FD. Regulation FD is designed to prevent selective disclosures by SEC-reporting issuers or issuers of securities registered under the Exchange Act of non-public material information to selected persons. Regulation FD does not apply to issuer communications with among others, rating agencies. However, within 90 days after enactment of the Act, the SEC is required to amend Regulation FD to remove the exemption for rating agencies.

   Note: Other exemptions from the disclosure requirements will continue to apply and may be relied upon by issuers and rating agencies, including the exemption provided by 17 C.F.R. 243.100 (b)(2)(ii) for disclosure "to a person who expressly agrees to maintain the disclosed information in confidence."

F. Removal of Statutory References to Ratings

1. Certain references to ratings as a criteria for various provisions of the securities and other federal laws will be removed. Instead, the applicable regulatory agency will have the discretion to establish appropriate credit-worthiness standards. This change will go into effect two years after the date of enactment of the Act.

   Note: Among other things, this change will affect shelf registration eligibility requirements, which previously limited registered ABS securities to those rated investment grade. Depending on the nature and subjectivity of the new criteria, shelf registration may become more complex or difficult.

2. Within one year after the date of enactment of the Act, each Federal agency must review references to credit ratings in its regulations and modify such regulations to remove any reference to the requirement of, or reliance on, ratings. The references to ratings will be replaced by

standards of credit-worthiness deemed appropriate by each Federal agency.

Note: Among other things, this will affect one of the common exemptions from registration under the Investment Company Act of 1940 used for many ABS issuances.

G. Studies

The Act requires that certain studies and reports be undertaken, including:

1. Report on Strengthening Agency Independence. The SEC must study the conflicts of interest raised by NRSROs providing services other than ratings and the impact of prohibiting a NRSROs from providing services other than ratings to an issuer. The report on the results of the study is due no later than three years after the date of enactment of the Act.

2. Study on Alternative Business Models. The Comptroller General must conduct a study on alternative means of compensation to create incentives to NRSROs to provide more accurate ratings. The report on this study is due no later than 18 months after the date of enactment of the Act.

3. Study and Implementation of Assigned Credit Ratings. The SEC must carry out a study of the rating process for structured finance products and the conflicts of interest associated with the issuer-pay model. It will evaluate the feasibility of establishing a system under which rating agencies are assigned to rate structured finance products; study the range of metrics that could be used to determine the accuracy of ratings; and consider alternative means of compensating rating agencies. The report is due 24 months after the date of enactment of the Act. After the report is submitted, the SEC will, as it determines necessary or appropriate in the public interest or for the protection of investors, establish a system providing for an independent body to be responsible for assignment of NRSROs that will rate structured finance products in a manner that prevents transaction parties from selecting the NRSRO that will provide the ratings. The SEC is required to implement the system added by the Franken Amendment to H.R. 4173 as passed by the Senate, unless it determines that another system would better serve the public interest and protection of investors.

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We hope you find this helpful. Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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COMPARISON OF DODD-FRANK ACT WITH SEC AND FDIC PROPOSED SECURITIZATION PROVISIONS

Provision	Dodd-Frank Act	FDIC NPR	SEC Reg AB Proposal
Credit Risk Retention:			
Credit Risk Retention Percentage:	5%.	5%.	5%. Retention requirement doesn't apply to non-shelf offerings (*i.e.*, public deals registered on Form SF-1 and private offerings).
Type of Risk Retained:	To be specified in regulations.	An interest (i) in each tranche or (ii) in a representative sample of the securitized financial assets.	An interest in (i) each tranche sold to investors or (ii) in the case of a revolving asset master trust, an originator's interest, provided the originator's interest and the securities sold to investors are backed by the same pool of receivables and payments on the originator's interest are not less than 5% of the payments on the securities held be investors collectively.
Duration of Risk Retention:	To be specified in regulations.	The term of the securitization.	As long as non-affiliates of the depositor hold any of the securities.
Risk Retention by Whom:	(i) A securitizer and (ii) an originator that sells an asset directly or indirectly to a securitizer.	Sponsor. Note that the FDIC safe harbor is only relevant to securitizations involving transfers of assets by FDIC-insured banks (not non-bank subsidiaries).	Sponsor or an affiliate.
Definition of "securitizer" or "sponsor":	(A) An issuer of an ABS; or (B) a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.	"A person or entity that organizes and initiates a securitization by transferring financial assets, either directly or indirectly, including through an affiliate, to an issuing entity. . ."	"The person who organizes and initiates an asset backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity."
Prohibition on Hedging:	Securitizers are prohibited from directly or indirectly hedging or otherwise transferring the credit risk.	The retained interest may not be transferred or hedged for credit risk during the term of the securitization.	Hedge positions directly related to the securities retained or exposures taken by the sponsor or affiliate are counted against the 5%.
Risk Sharing:	Yes. Risk can be allocated between a securitizer and an originator as jointly deemed appropriate by the federal banking agencies and the SEC, considering whether (i) the assets have terms, conditions and characteristics that reflect low credit risk, (ii) the form or volume of transactions in securitization markets creates incentives for imprudent origination of that type of asset and (iii) the potential impact of the risk retention obligations on access of consumers and businesses to credit on reasonable terms.	No.	No.

COMPARISON OF DODD-FRANK ACT WITH SEC AND FDIC PROPOSED SECURITIZATION PROVISIONS

Provision	Dodd-Frank Act	FDIC NPR	SEC Reg AB Proposal
Effective Date:	1 year after publication of regulations for residential mortgage loans; 2 years after publication of regulations for all other forms of ABS. Regulations are due within 270 days after legislation is enacted.	October 2010. Comments on NPR due by July 1, 2010.	Not specified. Comments on proposal due by August 2, 2010.
Exceptions to Credit Risk Retention:			
Regulatory Discretion:	Total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors. Exemptions, exceptions or adjustments to the rules on risk or risk retention, including the prohibition on hedging.	No.	No.
Qualified Residential Mortgages:	No risk retention requirement for any asset included in an ABS if all the assets backing the ABS are "qualified residential mortgages." Federal banking agencies, the SEC, Secretary of HUD and the Director of the Federal Housing Finance Agency must jointly define "qualified residential mortgages", taking into consideration underwriting and product features that historical data indicate result in a lower risk of default. This exception would not be available for resecuritizations.	No.	No.
Underwriting Guidelines:	Securitizers can retain less than 5% credit risk if the originator meets underwriting standards to be established for each asset class (*e.g.*, residential mortgages, commercial mortgages, commercial loans, auto loans, and other classes the federal banking agencies and the SEC deem appropriate), which specify terms, conditions and characteristics of a loan within each asset class that indicate a low credit risk.	No.	No.
First Loss Purchaser:	Regulations must specify, with respect to commercial mortgages, the permissible types, forms and amounts of risk retention, which may include (i) retention of a specified amount or percentage of total credit risk of the assets, (ii) retention of a first loss position by a 3rd party purchaser that specifically negotiates for the purchase of the first loss position, holds adequate financial resources to back losses, provides due diligence on all the pool assets prior to issuance of the ABS and meets the same standards for risk retention as the regulators require of the securitizer, (iii) determination by the federal banking agencies and the SEC that the underwriting standards and controls for the asset are adequate, and (iv) provision of adequate representations and warranties and related enforcement mechanisms.	No.	No.

COMPARISON OF DODD-FRANK ACT WITH SEC AND FDIC PROPOSED SECURITIZATION PROVISIONS

Provision	Dodd-Frank Act	FDIC NPR	SEC Reg AB Proposal
Governmental Guarantee Exclusion:	Credit risk retention provisions do not apply to: (i) any loan made, insured, guaranteed or purchased by any person subject to supervision by the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation; and (ii) any residential, multifamily or healthcare facility mortgage loan asset, or securitization based directly or indirectly on such asset, which is insured or guaranteed by the U.S. or any agency of the U.S. Fannie Mae and Freddie Mac are NOT agencies of the U.S. for this purpose.	No.	NA
Improved Disclosure:			
Continued Periodic Reporting with the SEC:	Yes. Requires continued filing of Exchange Act reports for registered ABS after the first fiscal year even if there are less than 300 holders of record. The SEC may suspend or terminate the duty to file for any class of ABS as necessary or appropriate in the public interest or for protection of investors.	No. However, the Proposed Rule requires periodic reporting to investors by the sponsor, issuer and/or servicer, as frequently as monthly, regarding asset performance, including data related to the substitution and removal of financial assets, servicer advances, and loss allocations.	Yes, for shelf-registered ABS, and for Rule 144A ABS offerings, and for other structured finance product offerings under Rule 144A.
Identity of Loan Brokers and Originators; Nature and Extent of Compensation; Amount of Risk Retained:	Disclose (i) identifiers relating to loan broker or originator, (ii) nature and extent of compensation of broker or originator and (iii) amount of risk retained by originator and securitizer. Applies to Securities Act filings.	Disclose the nature and amount of compensation paid to the originator, sponsor, rating agency or third-party advisor, and any mortgage or other broker, compensation expenses of servicers and the risk of loss retained by any such party.	Yes, as to nature and extent of interest in transaction retained by the sponsor or originator. Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D.
Assets Backing Each Class or Tranche:	Regulations must require issuers to disclose information regarding the assets backing each tranche or class of security. Applies to Securities Act filings.	Disclose asset, pool and security-level detail required prior to issuance and monthly while outstanding.	Yes. Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D.
Loan-Level Detail:	Regulations must require issuers to disclose asset level or loan level data if such data is necessary for investors to independently perform due diligence. Applies to Securities Act filings.	For residential mortgage loans, prior to issuance disclose loan-level information including, but not limited to, loan type, loan structure, maturity, interest rate and/or annual percentage rate, and location of property.	Yes as to all asset classes (or grouped account data for credit cards). Applies to ABS public offerings and offerings of ABS and other structured finance products under Rule 144A and Regulation D. Applies to offering documents and to ongoing reporting for public and Rule 144A offerings.
Standardization of Data Format Provided by Issuers:	Regulations must set standards for format of data provided by ABS issuers to facilitate comparison of data across securities of similar types and asset classes.	No.	Yes, for ABS public offerings and, it appears, for offerings of ABS and other structured finance products under Rule 144A and Regulation D.
Disclosure of Due Diligence Analysis:	Regulations regarding registration statements must require ABS issuers to perform a review of assets backing ABS and disclose the nature of such review.	For residential mortgage loans, sponsors must disclose a third party due diligence report on compliance with underwriting standards and representations and warranties.	No.

COMPARISON OF DODD-FRANK ACT WITH SEC AND FDIC PROPOSED SECURITIZATION PROVISIONS

Provision	Dodd-Frank Act	FDIC NPR	SEC Reg AB Proposal
Representations and Warranties:			
Description of Representations, Warranties and Enforcement Mechanisms and Comparison to Similar Transactions:	Regulations to require rating agencies to include in any report accompanying a credit rating a description of (i) the representations, warranties and enforcement mechanisms available to investors and (ii) how they differ from issuances of similar securities.	Disclose the representations and warranties made, the remedies for breach and the time period to cure. For residential mortgage loans, a reserve fund would be required in an amount equal to 5% of cash proceeds from the securitization payable to the sponsor, which reserve would be held for 12 months to cover any repurchases required for breaches of representations and warranties.	Disclose the representations and warranties made and the remedies for breach. Must disclose whether or not a fraud representation is made.
Disclosure of Repurchase Requests by Originator:	Regulations to require securitizers to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer, so investors may identify asset originators with clear underwriting deficiencies.	No.	Disclosure required for sponsors and 20% originators as to repurchase demands and performance during prior 3 years, including the percentage that was not then repurchased or replaced by the sponsor or originator and whether an opinion of an unaffiliated third party had been furnished to the trustee that confirms that the assets did not violate a representation or warranty. Disclosure also required of financial condition of warranting party to the extent the financial condition could have a material impact on repurchase ability. Shelf-registered ABS must require a warranting party to furnish an opinion or certificate, furnished to the trustee at least each quarter, from a non-affiliated third party relating to any asset for which the trustee has asserted a breach of a representation or warranty and for which the asset was not repurchased or replaced by the obligated party on the basis of an assertion that the asset did not violate a representation or warranty contained in the pooling and servicing agreement or other transaction agreement.
			Periodic reports must include disclosure of any repurchase demands made of the obligated party in the reporting period, including the percentage that was not then repurchased or replaced by the originator and whether an opinion of an unaffiliated third party had been furnished to the trustee that confirms that the assets did not violate a representation or warranty.